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Supreme Court, U.S.
FILED
JAN 11 1994
OFFICE OF THE CLERK

No. 93-695

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF COLUMBIA GAS TRANSMISSION CORPORATION,
Petitioner,

v.

COLUMBIA GAS TRANSMISSION CORPORATION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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REPLY BRIEF OF PETITIONER

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January 11, 1994

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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REPLY BRIEF OF PETITIONER

Desperate to sustain the preferential transfer of more than a hundred million dollars from Columbia Gas Transmission Corporation ("Debtor") to its corporate subsidiaries, respondents attempt the same federal common law sleight of hand embodied in the decision below. They contend that that decision is consistent with previous decisions of this Court and the other courts of appeals, because the Third Circuit properly applied this Court's decision in *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), in giving content to *federal* trust and property law. Even if that were true—and, as discussed below, it plainly is not—the appropriate framework for determining the content of federal law, *once it is determined that federal law applies*, is *not* the issue raised by the petition in this case. Rather, the issue presented by the petition is the appropriate framework for determining *when* a federal court sitting in bankruptcy may preempt state property laws in favor of federal law—whatever its content. On that issue respondents are noticeably silent, and on that important and recurring issue there is a clear conflict among the circuits that warrants further review by this Court.

1. As the respondent public utility commissions concede, "[a] federal court's choice between state and federal law has been consistently held to be governed by a two-prong test" under which the court first "must determine whether [it] has *authority* to apply federal law." Joint Brief in Opposition of the State Public Utility Commissions and Consumer Advocate Offices at 9 ("Public Utility Brief") (emphasis added). Respondents do not dispute that the decision below held that merely because a federal statute is involved, federal courts *must* apply federal law to determine what property rights exist under § 541(d) of the Bankruptcy Code, 11 U.S.C. § 541(d). Nor do they deny that in so ruling the Third Circuit authorized federal courts sitting in bankruptcy immediately to launch into the second prong of the federal common law test, namely the *Kimbell Foods* judicial balancing of state and

federal interests—an inquiry that this Court has acknowledged is "a matter of judicial policy" that allows federal courts to act " 'according to their own standards,' " *Kimbell Foods*, 440 U.S. at 727-28, —without first determining that Congress authorized such judicial lawmaking.

Whatever the merit of that approach, it plainly conflicts with the approach of the Seventh Circuit in an identical context—*i.e.*, a dispute under § 541(d) in which putative trust beneficiaries asserted "federal interests" related to a non-bankruptcy federal program as justifying preemption of state trust law. See *In re Iowa R.R.*, 840 F.2d 535 (7th Cir.), *cert. denied*, 488 U.S. 899 (1988). In contrast to the Third Circuit, the Seventh Circuit began by noting that the Bankruptcy Code, far from authorizing federal courts to override state property laws, generally requires application of those laws. *Id.* at 540. The court then observed that in such circumstances federal law can apply only if state law is preempted, which occurs only if there is a "concrete federal interest with which the application of state law would interfere." *Id.* ("[t]o say that there is a federal common law governing interests in funds received by rail carriers is to say that state law is preempted"). Because, as here, the putative trust beneficiaries in *Iowa Railroad* raised only abstract policy arguments, there was no "substantial conflict between state law" and any concrete federal interest. *Id.* Accordingly, the *Iowa Railroad* court *never* reached the *Kimbell Foods* balancing test; instead it held that under the established preemption jurisprudence of this Court state law applied of its own force.[1] Given that the decision below requires every court applying § 541(d)—or, indeed, any federal statute—to engage in the elastic *Kimbell Foods* balancing approach, there is a clear circuit split, and the Sixth Circuit was plainly correct when it described *Iowa Railroad* as "a complete rejection of" the Third Circuit's federal

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[1] The court cited *Kimbell Foods* only for the undisputed proposition that even where federal law *is* authorized, federal courts ordinarily should adopt state law as the federal rule of decision.

common law approach. *Missouri Pac. R.R.* v. *Escanaba & L.S. R.R.*, 897 F.2d 210, 213 (6th Cir. 1990).[2]

2. The Third Circuit's unprecedented expansion of the "narrow areas"[3] that were *automatically* covered by federal law to include *all* private "disputes which relate to a nationwide federal program," Public Utility Brief at 9, undermines this Court's efforts to protect fundamental federalism and democratic process concerns by carefully restricting the scope of federal judicial lawmaking.[4] Indeed, the Third Circuit view that it "is axiomatic that federal law governs questions involving the interpretation of a federal statute," Pet. App. 47a, would render superfluous much of this Court's preemption jurisprudence, which focuses on the language, structure, and purpose of federal statutes to determine whether *Congress* intended to preempt state laws. See, *e.g.*, *Hillsborough County* v.

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[2] Respondents argue that any conflict is unimportant because *Penn Central*, *Lehigh* and *Iowa Railroad* are "limited" to the interline railroad context. No language in any of the relevant decisions supports that proposition. Indeed, the decision below explicitly relied on *Penn Central* and *Lehigh*. *See* Pet. App. 51a ("[t]he same rationale [of *Penn Central* and *Lehigh*] applies here").

[3] *See Texas Indus., Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 641 (1981) ("absent some congressional authorization to formulate substantive rules of decision, federal common law exists only in such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of States or our relations with foreign nations, and admiralty cases").

[4] *See, e.g., City of Milwaukee* v. *Illinois*, 451 U.S. 304, 312-13 (1981) ("[t]he enactment of a federal rule . . . and the decision whether to displace state law in doing so, is generally made not by the federal judiciary, purposefully insulated from democratic pressures, but by the people through their elected representatives"); *Miree* v. *DeKalb County*, 433 U.S. 25, 32 (1977) ("the issue of whether to displace state law on an issue such as this is primarily a decision for Congress. Congress has not chosen to do so in this case"); *Wallis* v. *Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966) ("[e]ven where there is related federal legislation in an area, as is true in this instance, it must be remembered that 'Congress acts . . . against the background of the total *corpus juris* of the states").

Automated Medical Lab., Inc., 471 U.S. 707, 715 (1985) (no preemption in areas that traditionally have been regulated by the states "unless that was the clear and manifest purpose of Congress") (internal quotations omitted).[5]

To say that statutory interpretation raises a federal question is only to say that federal principles of statutory construction apply in determining congressional intent. See, *e.g.*, *NLRB* v. *United Food & Commercial Workers Union, Local 23*, 484 U.S. 112, 123 (1987). And, as this Court has previously recognized, "Congress has *generally* left the determination of property rights in the assets of a bankrupt's estate to state law." *Butner* v. *United States*, 440 U.S. 48, 54 (1979) (emphasis added).[6] The decision

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[5] The decision below cites this Court's decision in *Kamen* v. *Kemper Financial Services, Inc.*, 111 S. Ct. 1711 (1991), in support of the view that federal law governs in all cases involving statutory interpretation. Respondents add *United States* v. *Little Lake Misere Land Co.*, 412 U.S. 580 (1973). Neither case supports that view: the former involved a determination of the contours of a federal cause of action and the latter involved the rights and obligations of the United States itself; both fall squarely within the narrow areas in which it has long been settled that federal law governs. *See, e.g., Clearfield Trust Co.* v. *United States*, 318 U.S. 363 (1943); *Sola Elec. Co.* v. *Jefferson Elec. Co.*, 317 U.S. 173 (1942).

[6] Of course, "[t]he starting point in statutory interpretation is 'the language [of the statute] itself.'" *United States* v. *James*, 478 U.S. 597, 604 (1986) (second alteration in original). The Bankruptcy Code excludes from the bankruptcy estate property in which the Debtor holds "only legal title and not an equitable interest." 11 U.S.C. § 541(d). Those terms are no more than a restatement of the common-law definition of a trust. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 368 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6324 (section 541(d) covers situations "where property ostensibly belonging to the debtor will actually not be property of the debtor, but will be held in trust for another"). *See also* Black's Law Dictionary 1191 (1891) (defining trust as "[a]n equitable or beneficial right . . . held for the beneficiary by another person, in whom resides the legal title"). And, it is a well established "maxim that a statutory term is generally presumed to have its common-law meaning." *Taylor* v. *United States*, 495 U.S. 575, 592 (1990). *See also* Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 537

below authorizes federal courts, under the guise of statutory interpretation, to ignore congressional intent and to determine in the first instance—through their own balancing of policy interests—whether or not to apply state law.

That holding has broad implications both in the bankruptcy context, where the standardless federal common law of "trusts" threatens to derail the orderly bankruptcy distribution process,[7] and, more generally, by expanding greatly the role of the federal judiciary in determining when federal law should preempt state law. Recognizing the troubling implications of the holding below, respondents go to great lengths to assure the Court that the "Third Circuit's decision is clearly limited to the facts and circumstances of this case and cannot be construed as a general rule of law applicable to all industries." Brief in Opposition for Respondents Cities of Charlottesville, and Richmond, Virginia at 23. However, nothing in the decision below in any way limits the broad federal common law holding.

The importance of that federal common law issue is reflected in the Court's recent grant of certiorari in *O'Melveny & Myers* v. *FDIC*, 62 U.S.L.W. 3368 (U.S. Nov. 29, 1993) (No. 93-489). In *O'Melveny*, the Ninth Circuit preempted state tort law with federal common law in a legal malpractice action brought by the Federal Deposit Insurance Corporation, acting in its capacity as receiver for a failed financial institution. There, as here, the court of appeals justified preemption not by reference to the language, history, structure or purpose of the relevant statutes, but based its decision solely on its own determination that federal policy interests would be advanced by creating federal common law. Because the decision below impermissibly expands the scope of federal judicial lawmaking in the context of a purely *private*

(1947) ("if a word is obviously transplanted from another legal source, whether the common law or other legislation, it brings the old soil with it").

[7] *See* Pet. at 17-19.

dispute, it presents an even stronger case for this Court's review than does *O'Melveny*.[8]

3. Even assuming *arguendo* that Congress had authorized federal courts sitting in bankruptcy to apply federal law of property rights, the Third Circuit's approach to giving content to federal law conflicts with previous decisions of this Court and the other courts of appeals. As this Court has repeatedly cautioned, even when Congress has authorized the application of federal law, generally "federal courts should 'incorporat[e] [state law] as the federal rule of decision.'" *Kamen* v. *Kemper Fin. Servs., Inc.*, 111 S. Ct. 1711, 1717 (1991) (quoting *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 728 (1979)) (alteration in original). The approach of the Third Circuit effectively discards this "presumption that state law should be incorporated into federal common law," *id.*, and the resulting expansion of the lawmaking authority of the federal courts is alone sufficient to justify this Court's review of the decision below. Compare *Morgan* v. *South Bend Community Sch. Corp.*, 797 F.2d 471, 476 (7th Cir. 1986) ("[w]hen it is not necessary to have a national rule, it is necessary not to have one").

Respondents contend that the decision below is not sufficiently important to warrant further review, because the Third Circuit properly refused to incorporate state law principles into federal common law to avoid interference with a federal "goal of getting the refunds into the hands of the gas consuming public." Brief in Opposition for Respondent Official Committee of Customers of Columbia Gas Transmission Corporation at 12. This rationale does not withstand scrutiny and certainly does not justify denying certiorari.

First, by its own admission, the Third Circuit's assumption that it had authority to promulgate federal common law rested entirely on the fact that it was interpreting the *Bankruptcy Code*. In giving content to federal bankruptcy

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[8] At a minimum, the petition for certiorari in this case should be held pending resolution of the federal common law issue in *O'Melveny*.

law, however, the Third Circuit relied exclusively on its understanding of federal policies underlying the *Natural Gas Act*, a statute that does not even address property rights or payments in bankruptcy. Moreover, the federal common law trust "rule" crafted by the Third Circuit is directly contrary to Congress' *bankruptcy* policies of "[e]quality of distribution among creditors," *Begier* v. *IRS*, 496 U.S. 53, 58 (1990), and an orderly *statutory* distribution scheme. Thus, the approach of the Third Circuit authorizes federal courts to roam freely through the vast United States Code in search of "federal policy" —unrelated to, and indeed inconsistent with, federal bankruptcy interests—upon which to justify preferential payment to certain creditors in bankruptcy.

Second, even if the Natural Gas Act were relevant in determining what law should govern property rights determinations pursuant to § 541(d) of the Bankruptcy Code, none of the three *Kimbell Foods* factors—(1) the need for a nationally uniform rule, (2) whether incorporation of state law would frustrate *specific objectives* of the federal program, and (3) whether preemption of state law would upset commercial expectations—remotely justifies displacing the entire corpus of traditional state law trust principles with a purely result-oriented federal common law scheme.[9]

With respect to the first two factors, respondents merely parrot the decision below—a uniform national rule is necessary, they say, to protect them from "the vagaries of state law" and to avoid frustrating the Natural Gas Act's goal of "providing gas to the public at reasonable rates." However, as the Third Circuit itself has previously recognized, common law trust principles *are* uniform throughout the states. See *Smith* v. *Williams*, 698 F.2d 611, 614 (3d Cir. 1983). Moreover, the "uniform national rule"

[9] Respondents' suggest that the Third Circuit merely chose between two existing bodies of trust law—state law and federal common law. This is, of course, incorrect. As explained in the petition, prior to the decision below each of the few decisions applying federal trust law had incorporated state law trust principles.

crafted by the Third Circuit—federal law is whatever is necessary to ensure that gas distribution companies prevail over other creditors—is no rule at all. Thus, the Third Circuit replaced a uniform body of state law trust principles with an *ad hoc* federal determination. It is exactly this type of standardless judicial lawmaking that the incorporation doctrine was designed to prevent.

Nor does holding respondents to the same standards as other creditors frustrate any "specific objective" of the Natural Gas Act. Neither the court below nor any respondent points to *anything* in the language, history or structure of the Natural Gas Act (or in any prior decisions construing it) that in any way suggests that Congress intended to excuse state-regulated gas distribution companies from the state laws that govern property rights determinations in bankruptcy. As explained in the petition, the Natural Gas Act was a carefully crafted legislative solution to a single problem—the exercise of *monopoly power* by interstate pipeline companies that could not be adequately regulated by any single state. See Pet. at 16. Application of state trust and property law here will in no way invite monoply abuse by any pipeline; indeed, the Debtor pipeline *supports* its customers' request for immediate payment. And, contrary to respondents' misleading rhetoric, the fact that the FERC was established and given authority to order refunds to combat monopoly power in no way suggests that Congress also intended in enacting the Natural Gas Act to protect state-regulated gas distribution companies from all other risks faced by commercial entities—including the risk that payments will be delayed or reduced as a result of the bankruptcy of a trading partner.[10]

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[10] Application of state trust laws simply has *no* effect on the FERC's ability to order refunds to combat excessive rates. Although the Debtor's bankruptcy has interrupted the *payment* of its refund obligations—just as it has interrupted payments to thousands of other creditors—payment by bankrupts is a matter clearly controlled by the Bankruptcy Code, not the NGA. Thus, respondents' argument is really that the Bankruptcy Code should not be allowed to interfere with the payment of FERC-ordered

With respect to the third factor, respondents argue in circular fashion that the decision to ignore state-law trust principles cannot have upset commercial expectations, because no creditor could reasonably have expected to lay any claim to the refund monies. That, of course, begs the question. As respondents concede, *if* it was reasonable to assume that state law would apply to trust determinations in bankruptcy, then it was reasonable for the Debtor's creditors to assume that they would have legitimate claims against refund monies in the event of bankruptcy, just as *all* property that did not meet state-law trust requirements would be subject to their claims. And it plainly *was* reasonable to assume that state-law principles would apply to any trust determination in bankruptcy—prior to the decision below, *every* court to address the issue had applied traditional state law principles, either through the application of state law per se or through incorporation of state-law principles into the federal common law.[11]

Finally, Respondents' claim that holding the Debtor's customers to the same standards as all other claimants would produce a "windfall" to the Debtor's general creditors is meritless. On the contrary, all funds in the

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obligations. That is an argument that can only be made to Congress, not to a federal court.

[11] Every relevant FERC decision also supported this view. Respondents criticize petitioner for citing only one such decision, but there are numerous other decisions. *See, e.g., Silver Creek Oil & Gas, Inc.*, 42 FERC ¶ 62,153 (1988); *Transamerican Natural Gas Corp.*, 41 FERC ¶ 62,206, at 63,454 (1987) ("refusal to grant postponement of [the debtor's] refund obligation merely leaves the persons owed . . . refunds in the same position as [the debtor's] other creditors. Disposition of [the debtor's] assets in order to discharge its debts, including . . . refunds, is a matter for the court handling [the debtor's] bankruptcy proceeding"); *Florida Gas Transmission Co.*, 32 FERC ¶ 61,120, at 61,319 (1985) (staying payment of refund obligations "pending termination of [the debtor's] Chapter XI bankruptcy proceeding, unless payment in whole or in part is authorized by the bankruptcy court"); *Trice Prod. Co.*, 32 FERC ¶ 61,191 (1985) (extinguishing refund obligations in light of bankruptcy court's confirmation of reorganization plan).

Debtor's possession are non-trust property of the estate, against which thousands of unsecured creditors have legitimate claims. The *most* that these creditors can hope for is full payment of their legitimate claims, and that is not likely. The customers, by contrast, ask for a *guarantee* of full and immediate payment, despite the fact that they have no stronger ownership claim to the property of the estate than the Debtor's other general creditors. It is pure sophistry to characterize equal treatment of similarly situated parties as a windfall for some; it is respondents who seek a windfall in this case.

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At bottom, the decision below authorizes federal courts to distribute property held by bankrupts based upon no more than a federal court's own balance of the equities of competing claims. Nothing in either the Bankruptcy Code or the Natural Gas Act in any way suggests that Congress intended this radical departure from past law.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted. Alternatively, the Court should hold the petition pending the decision in *O'Melveny & Myers* v. *FDIC*, *supra*, and then dispose of the petition as appropriate in light of that decision.

Respectfully submitted,

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